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## Editorial

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# *The* JOURNAL of ACCOUNTANCY

*Official Organ of the* AMERICAN INSTITUTE OF ACCOUNTANTS

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A. P. RICHARDSON, *Editor*

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## EDITORIAL

### **The Suicidal Practice of Bidding**

An eminent authority writing on the subject of price cutting among public accountants gives some extraordinary details. He says that an engagement performed by his firm last year at an actual cost of \$8,000 was undertaken this year by a firm which bid for the work at a price of \$4,000 "flat." In another case an engagement for which the firm rendered a bill of \$17,500, was done by another firm, also after bidding, for a flat fee of \$7,500. This is a most striking illustration of the fallacy of bidding flat fees. Unfortunately there is nothing in the rules of conduct prescribed by the Institute which forbids the quotation of flat fees and it would be difficult to devise a rule which would fit the case. There are many instances in which an accountant may accept engagement on what is practically a retainer agreed in advance. Technically that might be described as a flat fee, but there is nothing at all in the highest standards of professional ethics to prevent the acceptance of a fixed retainer. Consequently to prohibit all flat fees would be absurd and probably fatuous. On the other hand it would be perfectly possible to enact a rule prohibiting competitive bidding, and that, we believe, will be one of the next rules adopted by the council of the American Institute of Accountants.

### **The Danger Will Be Seen**

It has been repeatedly said that the way in which to bring about abolition of bidding is to refrain from bidding. If all accountants will refuse to enter this form of competition, those who call for bids will be compelled to adopt some other method of obtaining the professional services which they require. The

chairman of the committee on professional ethics of the Institute recently said, "Quoting flat fees blindly is an evil that unfortunately is not covered by the rules of conduct. However, it violates the unwritten rule that accountants should maintain the dignity of the profession. Some day accountants will realize the harm that results." This is good doctrine. The accountant who bids places himself inevitably on a level with business and the public will no longer regard him as a professional man—that is to say the portion of the public possessed of discernment will not. Competitive bidding on the part of business men is eminently proper in the present state of commercial and industrial development. Sometime there may come a day when competition will be unnecessary, but none of us now living will witness it. Professional life may be no whit better than commercial life, and sometimes it is certainly far inferior, but the two things are never the same and it is idle to attempt to judge one class by the tenets of the other.

**The Immediate Effects of Bidding**

Now, take the case mentioned above, in which an engagement amounting in one year to \$17,500, was undertaken by another firm for \$7,500. Even if, for the sake of argument, it be admitted that perhaps the fee of the first firm was high, no one could possibly believe that it was \$10,000 too high. The work in the second year was to be practically the same and yet another firm professed a readiness to undertake it for \$10,000 less than the fee of the preceding year. There is only one answer and that is that the second firm in its eagerness to find occupation knowingly or ignorantly undertook a task which was certain to lead to a loss or to a failure to perform the full service required. There is no other way out a difficulty of that sort. Either the client loses if the accountant be dishonest or the accountant loses if he be honest. Both results are bad and both are the outcome of the reprehensible practice of bidding flat fees. Naturally a client may wish to know approximately what will be the expense involved in the employment of accountants and it is probably permissible for the accountant to estimate roughly what his fee will be. He may even go so far as to say that the fee will not exceed a certain amount, provided that that amount is sufficiently large to meet any combination of circumstances apt to arise. But it were infinitely better to avoid all fixity of fees and to have that relationship between client and accountant which exists in most

cases between client and lawyer. The man who has confidence in his lawyer or accountant should not find it necessary to enter into a hard and fast agreement on the question of prices. His confidence should run to the extent of confidence in the reasonableness of the professional man's fees. If it is needful to inquire exactly how much professional services will cost there must be a lack of that pure confidence which is always to be desired. More and more accountants are seeking to get away from the old rule that the per-diem rate should always prevail. Obviously, in the case of routine audit the per-diem rate is the best index of amount, but in all work requiring peculiar knowledge and exceptional judgment it is unfair to expect the accountant to charge a fee based solely upon the number of days devoted to the work. The whole question of accountants' fees is in an unsettled condition. Some firms have reached a point where they are not greatly disturbed by controversies over fees, but most accountants know to their sorrow that there are clients whose unchanging conviction it seems to be that the accountant's fee should always be disputed. Those who favor the flat-fee basis point to such clients and say, "Here is our reason for favoring the flat fee. It is not subject to dispute." And it must be confessed that there is a great deal of apparent logic in their contention. But, to go deeper, one finds that the fault lies in the mistaken theory of the client and of some accountants that the charge will be based upon whatever the traffic will bear rather than upon a "sweet reasonableness." As we have said, the way to bring an end to these undesirable conditions is by a universal refusal to have anything to do with competitive bidding.

**Depreciation and  
Interest Rates**

In a statement recently issued by a prominent realty company, the following paragraph appears:

**"DEPRECIATION**

"A charge is set aside annually for depreciation on the companies' buildings figured on a sinking fund basis at the rate of six per cent. per annum that a thoroughly modern fire-proof building kept in repair will last for seventy-five years. The companies' buildings and their equipment have been kept in thorough up-to-date repair and the increase in their reproductive cost would largely be in excess of any depreciation since their erection." This is a most interesting illustration of the extremes to which

those who favor the sinking-fund provision for depreciation may be led. Let us analyze the quoted statement. In the first place there will be a wide difference of opinion as to the justification for an expectation of seventy-five years' life. The great changes which are taking place in architecture and the use of buildings is such that he is indeed a brave man who would predict beyond a score of years. Even assuming, however, that a building may in the most favorable circumstances continue its useful life for seventy-five years it would be unwise to count upon any such length of life. Looking over the buildings of New York, or any other great American city, it would be difficult to find any building used for commercial purposes which has had a life of even half of seventy-five years. Of course we are not speaking now of the old houses which have been converted to commercial uses from an earlier purpose. The subject is now the large commercial venture.

**The Sinking-Fund  
Theory**

Passing that point for a moment, however, it is interesting to consider the statement that the depreciation is computed on a sinking-fund basis at the rate of six per cent. per annum. Presumably this involves compounding the interest annually. Now, in order to create a sinking fund on such a basis over a life of seventy-five years it would be necessary to set aside merely one thirteenth of one per cent. annually. Such is the force of interest compounded that one thirteenth of one per cent. annually in seventy-five years would amount to one hundred per cent. But this involves the ability to reinvest immediately at all times on a productive basis of six per cent. net. Not only that, but taking corporation income tax at the present rates, in order to produce six per cent. net the interest earnings must be increased by .82 per cent., and this of course increases the requirement to an ability to reinvest at 6.82 per cent. per annum. The company which can do this is highly favored by heaven.

**The Force of Com-  
pound Interest**

Another illustration of the force of interest and what we believe to be the fallacy of the so-called sinking-fund basis for depreciation is that if the expected life of a building were reduced from seventy-five to fifty years, it would be necessary to increase the rate of depreciation allowance four times in order to attain amortization of the principal; and if we bring the expected life down to a reasonable duration of, say, thirty years,

the rate must be increased more than three times again, so that by reducing extravagant expectation of life to something within the bounds of probability the rate of allowance for depreciation must be increased approximately fourteen times. There is no particular objection to the statement made by the company that depreciation is charged as it is charged, but it would be infinitely better, it seems to us, that there should be an adequate allowance and that even the casual reader might be put on notice. In the auditors' report the following reference to the matter occurs:

" . . . . . With respect to depreciation the accompanying consolidated balance-sheet and income account reflect only the provision therefor established by the companies. In the case of office and hotel buildings, depreciation has been computed on a 75 year 6% sinking-fund basis.

"Subject to the comments in the preceding paragraph, we certify that, in our opinion, the accompanying consolidated balance-sheet and condensed income account fairly present the financial position of the companies at December 31, 1930, and the results of their operations for the year ended that date."

This note of warning will be sufficient for the admonition of persons experienced in financial mathematics.

**Depreciation  
*ab initio***

It has been suggested by an accountant, who delights in computations, that the whole question of allowance for depreciation might be answered at the time of the foundation of the company by setting aside one dollar and a quarter out of every hundred dollars and placing that sum at compound interest with the assistance of the peculiar financial ability to invest and reinvest at 6.82 per cent. per annum and thereafter make no further provision for depreciation at all, allowing the original allotment of one dollar and a quarter to work out the salvation of the whole company. Interest is an extraordinary thing and there may be a great deal of merit in the suggestion to which we have referred. All that is necessary to bring about complete success for the proposal is a life beyond the normal span of man or building and the continuance of an extraordinarily high rate of interest over that long life. If these can be assured the rest is easy.

**Scottish Accountants  
Honored**

A recent issue of *The Weekly Scotsman*, the paper which most Scotsmen would probably describe as the leader in its field, contained a brief report of a dinner given at the North

British station hotel, Edinburgh, when Lord Provost Thomas B. Whitson of Edinburgh and Lord Provost Thomas Kelly of Glasgow were the guests of honor. The occasion was noteworthy because it was the first time when both lord provostships had been held by chartered accountants. The office of lord provost in Scotland is equivalent to that of lord mayor or chief magistrate in England, and here we find the capital and intellectual center of Scotland and the great commercial center electing to the office of lord provost members of the profession of accountancy. It is customary for anyone filling the position of lord provost to receive from the king a baronetcy, or at least a knighthood, upon retirement from office. Elevation of two chartered accountants to occupy these high positions is a striking honor to the profession in the country where accountancy was first recognized as a profession. We extend cordial congratulations to Lord Provost Whitson and Lord Provost Kelly and to the profession in their great country.

**Accountants in International Affairs**

The settlement of the Mexican debt question, announced recently in the daily papers, is an excellent illustration of the place which accountancy may occupy in international affairs. The complexity of the Mexican debt, affected by the changing political conditions and the grave decline in the value of silver, called for expert opinion and it is gratifying to know that in this vitally important question the two countries most concerned, namely, Mexico and the United States of America, were represented by professional accountants. To their competent analysis of the various factors involved is almost wholly due the success which attended the negotiations. The accountancy profession is to be congratulated upon having rendered this important service to the fair settlement of a matter of vital interest to the two countries.

**Accommodations for the Audit Department**

A correspondent who evidently knows whereof he speaks sends us the following directions for companies employing accountants. The question of finding accommodations for the audit department is the text upon which the argument is based.

Then follow these twelve excellent rules:

1. Choose as noisy an office as possible, preferably near a street-car intersection or corner with automatic traffic signals.

2. Exclude daylight with partitions and window shades. Arrange artificial light so that workers at desks will always be in their own shadow.

3. If a factory, place the accounting department immediately over a boiler shop, near plant whistle signal, riveting machines and trip-hammers.

4. Fix office telephones close to auditors' desks so that people using them can shout down the accountants when calling over postings, etc.

5. Have a few typewriters, billing machines and addressographs hammering incessantly within hearing of auditors.

6. Arrange broken swivel or tip-up chairs for accountants, either too high or too low for the desks. Chair legs, of unequal lengths, should emit squeaks when the occupant moves, breathes, speaks or clears throat.

7. Modulate ventilation and heating so that auditors are always either roasted or frozen, according to the season.

8. See that the required books and records are put away in vaults, cellars or cupboards, preferably in newspaper parcels with no exterior indication of the contents, and with the keys mislaid.

9. Arrange for inadequate safe accommodation for the books in use, so that half an hour or more must be wasted every evening in putting them away.

10. Have all adding machine tapes within a few inches of exhaustion, and no more in stock. A delay of a day or two should occur in replacing these.

11. Typists assigned to assist auditors should be blissfully ignorant of figures and have had no experience with tabular work.

12. Complain violently at the unreasonable length of time consumed on the work and at the exorbitant amount of the bill.

This admonition to companies is somewhat similar to the rules laid down by a conductor of the orchestra at the Metropolitan opera house in New York urging all patrons to arrive late, to rustle newspapers and programmes, to push past other patrons, to talk, to cough and to do a hundred other things which are encouraging to the artists on the stage.

#### **Inventory Valuation Again Arises**

A correspondent in Utah commenting upon editorial notes which appeared in the December issue of *THE JOURNAL OF ACCOUNTANCY*, says that he believes from the general trend of comments that this magazine is not in favor of the theory that the accountant should certify the physical count and quality of inventory. He continues: "It happens that I was invited to give a lecture before a body of bankers on the topic 'The analysis of the financial statement.' The value to the banker of an audit of



the accounts of a customer by a certified public accountant was touched upon. During the discussion one member, who had been the bookkeeper for a rather large mercantile institution, and had later taken up the occupation of banking, raised a question concerning the verification of inventory. He said that he had seen several audits, both by local firms and also by firms of nationwide activities, and that he had never yet seen any serious effort to verify the inventory. About all that any of the auditors did was to check a few extensions, ask a few questions, perhaps look at a few invoices, get a certificate from the manager or some other officer of the company, and pass the problem without any physical count or check. 'Now,' said this banker 'the inventory is the most flexible item on the balance-sheet. Here, if anywhere, there is a chance for padding. Of what value to the banker is an audit which passes up such a problem without any serious effort at checking it?' And now, Mr. Editor, let me pass the question up to you. Of what value to the banker is a certified statement when the inventory has not been checked?"

**Reaching Out for  
the Moon**

This is an old question but one that seems to be of perennial interest. We may admit at once that if it were possible for the accountant to certify that the statement of inventory was correct in every way it would be a most happy consummation. It would also be delightful if the accountant could certify to the health of all the employees of a corporation or could guarantee the success of every commercial venture. But the truth of the matter is that he could do none of these things because he has not, and except in rare instances can not have, the requisite knowledge. It would be almost as easy to give a certificate of health of personnel as of accuracy of inventory. It is all fine enough for the banker to say that he wants this or wants that. We all do. Everybody wants everything he wants, but that does not bring the unattainable to hand. As has been said repeatedly, there are a few small businesses or businesses having a very much restricted variety of output, in which an accountant familiar with them can certify as to correctness of inventory. But they are so few that they do not affect the general principle. The trite examples of a jeweler's shop, a department store, a steel mill and others might be cited again to demonstrate how impossible it is for an accountant to know enough of measurements and qualities to express an

opinion of any significance. This has all been said many times, but it might be said further that the banker who expects an accountant to be an appraisal company and an insurer has lost sight of the function of an accountant, and the accountant who, except in the rare instances mentioned, assumes liability for the accuracy of inventory count and value is courting disaster. Furthermore, the question of the banker, as to what value there could be in an accountant's certificate which did not cover inventories in detail, must have been asked by a banker unacquainted with the true nature of accountancy. It may be flattering to the accountant to tell him that he is to know all things, but if the accountant is not a fool he will admit that there are some things which he can not know. Of course this does not mean that the accountant should not exercise every precaution available to him to see that the inventories are correctly stated. It does mean that the accountant can not guarantee the accuracy of the ordinary inventory of merchandise in either quantity or quality.

**The Other Side of  
Restrictive Laws**

The attention of readers is directed to a letter from Arthur Berridge, a member of the American Institute of Accountants and a member of the American Bar Association, appearing elsewhere in this issue of *THE JOURNAL OF ACCOUNTANCY*. This letter discusses the validity of restrictive legislation affecting the profession of accountancy. It is an able exposition of the side of the question opposed to that adopted by this magazine. We are glad indeed to have an opportunity to publish so calm and well reasoned an expression of the opposition's view. We may disagree with the theory that restrictive legislation will be held constitutional in most of the states, but it is certain that the question must be brought to adjudication, and if every one will approach the matter in the same fair and friendly manner as that displayed by Mr. Berridge we shall go far toward an amicable solution of a much vexed problem. The trouble with most of us is that when we take sides we forget that they are sides and not the whole question. It is easy to be intolerant—terribly difficult to be tolerant. In a question like that of restrictive legislation there is so much personal feeling that calmness is rarely attained, and we therefore commend Mr. Berridge's letter to the careful consideration of those who agree and those who disagree with him. He appears to us to have taken the wrong side but he has taken it so pleasantly

that he seems to be one of those who "do as adversaries do in law—strive mightily, but eat and drink as friends."

**"The Customer Is  
Always Right"**

It is the custom among many enlightened business concerns to adopt the policy that the customer is always right and upon this fundamental theory some of the greatest business fortunes of the country have been built. The thesis is, of course, that the amount of loss involved in unjust claims by customers will be more than compensated by the increased prestige and advertisement created by the reputation for making good. Here again, however, the essential differences between the principles of business and profession are clearly manifest. Whereas the business man may say that the customer is always right, the professional man may be almost justified in saying that the client is always wrong. A correspondent says "there may be some excuse for the adoption by a merchant of such a slogan and the practice which its adoption implies, possibly on the grounds that the usual matter complained of by the customer is trivial and time and money are saved by unquestioned acquiescence with his views. Even where the matter is not trivial, a reputation for service and amiability may create a goodwill offsetting the cost of the adjustment. Viewing it from an ethical basis, is it not a servile bending of the knee to the almighty dollar carried by the so-much-to-be-desired customer? We are now in the midst of a period of window dressing, when not only the shop windows are dressed, but the same treatment is being applied in some instances to the accounts of a bad business year and the annual reports to stockholders. This is a good time to show whether the public accountant is a shop-keeper or a professional man; whether he bends the servile knee and adopts the slogan 'The customer is always right' or whether he has the professional training and instincts to resist attempts at chicanery, even at the cost of losing the 'customer'."

**Slogans Not for  
Professions**

It will be remarked that the correspondent quotes the word "customer" when speaking of some practices, and we think it might be safe to infer that the accountant who would be guilty of an undue recognition of a client's claim that this or that was so without verification could be regarded as engaged in business and therefore his clients would be customers. Slogans

are frequently silly and often dangerous. The catch word "the customer is always right" is supposed to be the antithesis of the older expression, written in doubtful Latin, "caveat emptor" and it is said to mark the transition from old custom to new. In the case of professions the adoption of slogans may be even more dangerous than it is in business, but if slogan there is to be, for any profession, it should be "the client is not right unless he is found to be." The correspondent who sends these opinions is moved by the contemplation of a real weakness of all the professions. It is particularly evident in a time when business depression leads to inactivity of professional offices. The professional man like every other man wants to make a decent living and sometimes he may be tempted to obliterate the word "decent" by too much willingness to kowtow to the demands of clients. It is not true, however, that the number of subservient professional men constitutes an appreciable percentage of the total. We believe that most professional men are ready enough to consign the unreasonable or crooked client to the depths, even at the cost of a fee.